

09-2068  
CENTRALLY ASSESSED PROPERTY  
TAX YEAR: 2009  
SIGNED: 06-01-2009  
COMMISSIONERS: R. JOHNSON, M. JOHNSON, C. CRAGUN  
EXCUSED: D. DIXON  
GUIDING DECISION

---

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,  Petitioner,  v.  PROPERTY TAX DIVISION OF THE UTAH STATE TAX COMMISSION,  Respondent.  and  COUNTY,  Intervening Party.	<b>INITIAL HEARING ORDER</b>  Appeal No. 09-2068  Account No. ##### Tax Type: Property Tax/Centrally Assessed Tax Year: 2009  Judge: Chapman
---	--

**This Order may contain confidential "commercial information" within the meaning of Utah Code Sec. 59-1-404, and is subject to disclosure restrictions as set out in that section and regulation pursuant to Utah Admin. Rule R861-1A-37. The rule prohibits the parties from disclosing commercial information obtained from the opposing party to nonparties, outside of the hearing process. However, pursuant to Utah Admin. Rule R861-1A-37, the Tax Commission may publish this decision, in its entirety, unless the taxpayer responds in writing to the Commission, within 30 days of this notice, specifying the commercial information that the taxpayer wants protected. The taxpayer must mail the response to the address listed near the end of this decision.**

**Presiding:**

Marc B. Johnson, Commissioner  
Kerry R. Chapman, Administrative Law Judge

**Appearances:**

For Petitioner:	PETITIONER REP. 1, Attorney PETITIONER REP. 2, Attorney PETITIONER REP. 3, Witness PETITIONER REP. 4, Witness PETITIONER REP. 5, Witness
For Respondent:	RESPONDENT REP. 1, Assistant Attorney General RESPONDENT REP. 2, from Property Tax Division

Appeal No. 09-2068

For COUNTY:                      RESPONDENT REP. 3, from Property Tax Division  
   COUNTY REP. 1, Deputy COUNTY Attorney  
   COUNTY REP. 2, Witness

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing on April 5 and 6, 2010 in accordance with Utah Code Sec. 59-1-502.5.

For the 2009 tax year, Property Tax Division assessed the value of the centrally assessed property of PETITIONER ("PETITIONER" or "taxpayer") at \$\$\$\$\$. PETITIONER filed a timely appeal of the assessment. Although COUNTY did not appeal the Division's assessment, it submitted a Motion for Leave to Intervene in this appeal, which the Commission granted on September 3, 2009.

PETITIONER asks the Commission to reduce the 2009 value of its property to \$\$\$\$\$. The Division and COUNTY ask the Commission to increase the value of PETITIONER's property to \$\$\$\$\$.

APPLICABLE LAW

Article XIII, Section 2(1) of the Utah Constitution provides, as follows:

(1) So that each person and corporation pays a tax in proportion to the fair market value of his, her, or its tangible property, all tangible property in the State that is not exempt under the laws of the United States or under this Constitution shall be:

- (a) assessed at a uniform and equal rate in proportion to its fair market value, to be ascertained as provided by law: and
- (b) taxed at a uniform and equal rate.

The valuation of mining property is governed by Utah Code Ann. §59-2-201, as follows in pertinent part:

....

(3) The method for determining the fair market value of productive mining property is the capitalized net revenue method or any other valuation method the commission believes, or the taxpayer demonstrates to the commission's

satisfaction, to be reasonably determinative of the fair market value of the mining property. The rate of capitalization applicable to mines shall be determined by the commission, consistent with a fair rate of return expected by an investor in light of that industry's current market, financial, and economic conditions. In no event may the fair market value of the mining property be less than the fair market value of the land, improvements, and tangible personal property upon or appurtenant to the mining property.

Utah Admin. Rule R884-24P-7 ("Rule 7") provides additional guidance on the assessment of mining properties, as follows in pertinent part:

A. Definitions

1. "Allowable costs" means those costs reasonably and necessarily incurred to own and operate a productive mining property and bring the minerals or finished product to the customary or implied point of sale.

a) Allowable costs include: salaries and wages, payroll taxes, employee benefits, workers compensation insurance, parts and supplies, maintenance and repairs, equipment rental, tools, power, fuels, utilities, water, freight, engineering, drilling, sampling and assaying, accounting and legal, management, insurance, taxes (including severance, property, sales/use, and federal and state income taxes), exempt royalties, waste disposal, actual or accrued environmental cleanup, reclamation and remediation, changes in working capital (other than those caused by increases or decreases in product inventory or other nontaxable items), and other miscellaneous costs.

b) For purposes of the discounted cash flow method, allowable costs shall include expected future capital expenditures in addition to those items outlined in A.1.a).

c) For purposes of the capitalized net revenue method, allowable costs shall include straight- line depreciation of capital expenditures in addition to those items outlined in A.1.a).

d) Allowable costs does not include interest, depletion, depreciation other than allowed in A.1.c), amortization, corporate overhead other than allowed in A.1.a), or any expenses not related to the ownership or operation of the mining property being valued.

e) To determine applicable federal and state income taxes, straight line depreciation, cost depletion, and amortization shall be used.

....

5. "Discount rate" means the rate that reflects the current yield requirements of investors purchasing comparable properties in the mining industry, taking into account the industry's current and projected market, financial, and economic conditions.

....

9. "Fair market value" is as defined in Section 59-2-102.

....

12. "Net cash flow" for the discounted cash flow method means, for each future year, the expected product price multiplied by the expected annual production that is anticipated to be sold or self-consumed, plus related revenue cash flows, minus allowable costs.

....

15. "Productive mining property" means the property of a mine that is either actively producing or currently capable of having economic production. Productive mining property includes all taxable interests in real property, improvements and tangible personal property upon or appurtenant to a mine that are used for that mine in exploration, development, engineering, mining, crushing or concentrating, processing, smelting, refining, reducing, leaching, roasting, other processes used in the separation or extraction of the product from the ore or minerals and the processing thereof, loading for shipment, marketing and sales, environmental clean-up, reclamation and remediation, general and administrative operations, or transporting the finished product or minerals to the customary point of sale or to the implied point of sale in the case of self-consumed minerals.

....

#### B. Valuation

1. The discounted cash flow method is the preferred method of valuing productive mining properties. Under this method the taxable value of the mine shall be determined by:

- a) discounting the future net cash flows for the remaining life of the mine to their present value as of the lien date; and
- b) subtracting from that present value the fair market value, as of the lien date, of licensed vehicles and nontaxable items.

2. The mining company shall provide to the Property Tax Division an estimate of future cash flows for the remaining life of the mine. These future cash flows shall be prepared on a constant or real dollar basis and shall be based on factors including the life-of-mine mining plan for proven and probably reserves, existing plant in place, capital projects underway, capital projects approved by the mining company board of directors, and capital necessary for sustaining operations. All factors included in the future cash flows, or which should be included in the future cash flows, shall be subject to verification and review for reasonableness by the Property Tax Division.

4. The discount rate shall be determined by the Property Tax Division.

- a) The discount rate shall be determined using the weighted average cost of capital method, a survey of reputable mining industry analysts, any other accepted methodology, or any combination thereof.
- b) If using the weighted average cost of capital method, the Property Tax Division shall include an after-tax cost of debt and of equity. The cost of debt will consider market yields. The cost of equity shall be determined by the capital asset pricing model, arbitrage pricing model, risk premium model, discounted cash flow model, a survey of reputable mining industry analysts, any other accepted methodology, or a combination thereof.

5. Where the discount rate is derived through the use of publicly available information of other companies, the Property Tax Division shall select

companies that are comparable to the productive mining property. In making this selection and in determining the discount rate, the Property Tax Division shall consider criteria that includes size, profitability, risk, diversification, or growth opportunities.

6. A non-operating mine will be valued at fair market value consistent with other taxable property.

7. If, in the opinion of the Property Tax Division, these methods are not reasonable to determine the fair market value, the Property Tax Division may use other valuation methods to estimate the fair market value of a mining property.

8. The fair market value of a productive mining property may not be less than the fair market value of the land, improvements, and tangible personal property upon or appurtenant to the mining property. The mine value shall include all equipment, improvements and real estate upon or appurtenant to the mine. All other tangible property no appurtenant to the mining property will be separately valued at fair market value.

9. Where the fair market value of assets upon or appurtenant to the mining property is determined under the cost method, the Property Tax Division shall use the replacement cost new less depreciation approach. This approach shall consider the cost to acquire or build an asset with like utility at current prices using modern design and materials, adjusted for loss in value due to physical deterioration or obsolescence for technical, functional, and economic factors.

....

#### DISCUSSION

The property at issue in this appeal is PETITIONER's mining property, which includes ( WORDS REMOVED ). Section 59-2-201(3) provides that "[t]he method for determining the fair market value of productive mining property is the capitalized net revenue method or any other valuation method the commission believes, or the taxpayer demonstrates to the commission's satisfaction, to be reasonably determinative of the fair market value of the mining property." Rule 7(B)(1) provides that "[t]he discounted cash flow method is the preferred method of valuing productive mining properties." PETITIONER has used the discounted cash flow ("DCF") method to derive a 2009 value of \$\$\$\$ for its property, while the Division has used the same method to derive a 2009 value of \$\$\$\$.<sup>1</sup> The County supports the Division's DCF model and value.

---

<sup>1</sup> The unadjusted value that the Division derived with its revised DCF model was \$\$\$\$\$. Adjustments reduced this value to the \$\$\$\$\$ value requested by the Division.

Although PETITIONER developed a value of \$\$\$\$\$ with its revised DCF model, it asks the Commission to reduce the value of its property to \$\$\$\$\$, which it states is the cost approach value of its assets. PETITIONER explains that the cost approach value is appropriate when it is higher than the DCF approach value, given its interpretation of Section 59-2-201(3), which provides that “[i]n no event may the fair market value of the mining property be less than the fair market value of the land, improvements, and tangible personal property upon or appurtenant to the mining property.”<sup>2</sup> The Commission is not convinced that the cost approach and income approach cannot be reconciled when the cost approach is higher than the income approach, or even that the cost approach necessarily trumps the income approach. Neither is the Commission convinced that a market or some other approach could not be used to determine the value of land, improvements, and tangible personal property. However, as explained later in the decision, this situation does not arise, as the Commission concludes that PETITIONER’s income approach value is higher than its cost approach value.

There are two major differences between PETITIONER’s and the Division’s DCF models that the parties ask the Commission to address.<sup>3</sup> First, the Division applied a single discount rate to all of PETITIONER’s revenues and costs in estimating a value with the DCF approach. PETITIONER argues that two discount rates should be used, specifically one “risk-free” rate applied to reclamation and remediation costs and another rate applied to revenues and all other costs. Second, PETITIONER contests the discount rate that the Division “built up,” as shown in Exhibit 21. PETITIONER argues that

---

<sup>2</sup> The Division derived a cost approach value of \$\$\$\$\$ for PETITIONER’s property (Exhibit 10). As the Division’s income approach value \$\$\$\$\$ was higher than its cost approach, the Division has proposed that PETITIONER’s value be set at \$\$\$\$\$ value.

<sup>3</sup> Other minor differences appear to have once existed between the parties’ respective models. PETITIONER points out that it has “corrected” some errors that appeared in its original 2009 property tax return, as follows: 1) ELEMENT 1 prices had been reported in nominal dollars instead of real dollars; 2) long-term ELEMENT 1 prices were higher than reported; 3) pension costs were adjusted due to investments to support the pension plan had decreased in value; and 4) residual land value. These specific changes appear to have been accepted by the Division and used in its revised DCF model (Exhibit 11).

one component the Division used to build up its discount rate, specifically the Risk Premium Model, is inappropriate and should be excluded in developing the discount rate.<sup>4</sup>

**I. Use of Separate Discount Rates in DCF Model.**

Section 59-2-201(3) provides that “[t]he rate of capitalization applicable to mines shall be determined by the commission, consistent with a fair rate of return expected by an investor in light of that industry’s current market, financial, and economic conditions.” Rule 7 provides additional guidance concerning the discount rate. Rule 7(B)(4)(a) provides that the discount rate shall be determined by the Division “using the weighted average cost of capital method, a survey of reputable mining industry analysts, any other accepted methodology, or any combination thereof.” Rule 7(B)(5) provides that when deriving the discount rate through the use of publicly available information of other companies, the Division “shall select companies that are comparable to the productive mining property” and “consider criteria that includes size, profitability, risk, diversification, or growth opportunities.”

In determining a 2009 value for PETITIONER’s property, the Division used a DCF model in which it discounted all revenue and expense cash flows with a single discount rate of %%%% (%%%% weighted average cost of capital (“WACC”) plus a %%%% weighted average property tax rate). Exhibit 11. PETITIONER, however, contends that two discount rates should be applied to its revenues and costs. PETITIONER argues that a %%%% “risk-free” rate should be applied to its remediation and reclamation costs, while a higher rate more similar to the Division’s single rate should be applied to its remaining revenues and expenses.<sup>5</sup> Applying a separate, lower risk-free rate to

---

<sup>4</sup> Although the parties did not ask the Commission to address other issues, the Commission points out that the operating cash flows and the final year (2020) reclamation and remediation costs used by PETITIONER and the Division in their respective DCF cash flow models are significantly different and are additional reasons why the parties’ income approaches are so far apart.

<sup>5</sup> PETITIONER originally proposed a 2009 risk-free rate of %%%%, based on a competitor’s equivalent bond Yield to Maturity rate. However, PETITIONER later determined that the %%%%

PETITIONER's 2009 reclamation and remediation costs instead of discounting all cash flows with a single rate decreases PETITIONER's DCF value by more than \$\$\$\$\$.

PETITIONER has a current responsibility to perform various reclamation and remediation mining operations, which is reflected in the financial statements of its parent company, COMPANY 1. PETITIONER explains that, upon closure, it is required to remediate its operating site under the terms of its operating permits. This includes dismantling buildings and other operating facilities, cleaning up soils and water, re-contouring mine waste dumps and re-vegetating the dumps and tailings impoundment. Clean-up costs are also incurred throughout the mine life and then into perpetuity, the biggest single cost being for contaminated groundwater. PETITIONER argues that the risk associated with these "negative" cash flows is fundamentally separate from that of the cash flows from continuing operations and that a separate, risk-free rate should be applied to its reclamation and remediation costs.

To settle PETITIONER's 2008 tax year valuation, the Division agreed to use a separate, risk-free rate to value PETITIONER's 2008 reclamation and remediation costs. PETITIONER argues that the Division should apply the same methodology and use a separate, risk-free to value these costs for 2009, as well. The Division contends, however, that use of a separate, risk-free rate did not have a significant impact on 2008 value.<sup>6</sup> In addition, the Division stated that it only agreed to the separate discount rates in 2008 to resolve the 2008 appeal, not because it thought such a methodology was correct.<sup>7</sup>

---

risk-free rate was a "nominal" rate that needed to be adjusted to a "real" rate of %%% to account for inflation in accordance with Rule 7, which requires "real" cash flows to be used in the DCF method.

<sup>6</sup> Applying a separate risk-free rate to the reclamation and remediation costs in 2008 resulted in a %%% reduction in value, as opposed to a %%% reduction in 2009. The difference between the two years is due to: 1) PETITIONER's reported reclamation and remediation costs increasing between 2008 and 2009; and 2) its proposed risk-free rate decreasing from %%% in 2008 to %%% in 2009.

<sup>7</sup> The Commission is concerned with the Division using a method in the previous year that it considers inappropriate, while justifying the practice by stating the impact was minimal.



PETITIONER REP. 3, a CPA and employee of PETITIONER, stated that COMPANY 2, its outside auditor, uses International Accounting Standards (“IAS”) developed by the International Accounting Standards Board (“IASB”) instead of the Generally Accepted Accounting Principles (“GAAP”) or Financial Accounting Standards (“FAS”) developed by the Financial Accounting Standards Board (“FASB”). PETITIONER REP. 3 explained that the IAS direct that closure costs (such as reclamation and remediation costs) be recognized as a liability and discounted with a risk-free rate to determine the amount that is “booked” for financial reporting purposes. As a result, COMPANY 1 uses a risk-free rate to estimate PETITIONER’s closure costs on its financial statements. PETITIONER REP. 3 further explained that these standards are used so that PETITIONER’s “fair value” is reported to investors.

PETITIONER REP. 4, a professor of finance at UNIVERSITY (“UNIVERSITY”), testified on behalf of PETITIONER. He proffered an article he wrote on bifurcated discount rates entitled TITLE. Exhibit 18. PETITIONER REP. 4 stated that he has determined that while a single WACC discount rate is appropriate for “positive cash flows,” current accounting standards, such as FAS #143,<sup>8</sup> require the application of a risk-free rate to determine the value the negative cash flows related to remediation costs in order to determine and record the “fair value” of this liability.

PETITIONER REP. 4 testified that the use of a separate, risk-free rate to value a negative asset is not only an accounting concept, but also a valuation concept. He explained that current trends in regulation indicate that future reclamation costs may be even more sizable than they are today. As a result, he contends that a buyer will require a “higher price” for the negative asset to be willing to take on these risks and accept the liability. PETITIONER REP. 4 also states that PETITIONER’s reclamation

---

<sup>8</sup> FAS 143 requires that, for some assets, an adjustment for the future retirement costs of the asset be included in the financial statements (Exhibit 18, p. 40). PETITIONER REP. 4 states that the FAS and IAS are similar on this point.

and remediation costs are higher and will be incurred sooner than the reclamation costs of the six comparable mining companies that the Division used in the development of its WACC. For these reasons, he believes it to be appropriate to value PETITIONER's reclamation and remediation costs with a separate, risk-free rate when determining PETITIONER's value for property tax purposes.

PETITIONER REP. 5, a professor of accounting at UNIVERSITY, also testified on behalf of PETITIONER.<sup>9</sup> He stated that in accounting, a "provision" is "where the timing and amount of a liability is uncertain" and that the amount recognized as a provision should be based on its "fair value." He explained that a "liability-specific premium" exists because of the uncertainty associated with "locking in" a current price for a project or cost, such as reclamation and remediation costs, that will not occur until far into the future. PETITIONER REP. 5 stated that the use of a separate, risk-free rate would account for the higher price of such costs under the IAS, on which COMPANY 1's accounting system is based. PETITIONER REP. 5 explained that the discount rate applied to closure costs under GAAP or FAS would be different than the rate applied under IAS, because GAAP and FAS measure the value of the "promise" to clean-up the contamination, which is lower than the IAS "fair value" of the liability, or obligation, itself. Regardless, he believes that the closure costs should be discounted at a rate different from the rate used to value other cash flows. PETITIONER REP. 5 stated that he believes that "fair value," as used for accounting purposes and determined under the IAS, is similar to "fair market value," as defined in Section 59-2-102 for Utah property tax purposes.

The Division and County argue that using a separate discount rate for PETITIONER's reclamation and remediation costs is inappropriate. The Division argues that the post-closure liability

---

<sup>9</sup> The Division and the County moved to exclude the testimony of PETITIONER REP. 4 and PETITIONER REP. 5 on the basis that their testimony, though reliable and generally accepted in the accounting community, would not be reliable and generally accepted in the appraisal community. The Commission, however, denied the request and allowed both witnesses to testify.

would not be purchased separately from its other operations, which PETITIONER did not refute. In addition, the Division and County point out that Rule 7 anticipates that reclamation and remediation costs will be valued with the same discount rate used to value other revenues and costs.<sup>10</sup>

The Division and County argue that PETITIONER's proposed methodology would result in an obsolescence adjustment (i.e., a liability value) being applied to the DCF model, which they claim is a fundamental violation of valuation and accounting principles and theory. They claim that reclamation and remediation expenses should be treated as normal operating expenses in a DCF approach to value and are accounted for in a DCF model derived with a single discount rate. The Division recognizes that some authorities have stated that separate "projects" can be valued separately with different discount rates.<sup>11</sup> The Division, however, contends that PETITIONER's property involves one asset (i.e., one unit) and that it is not comprised of separate projects.

The Division also admits that PETITIONER's estimated clean-up costs, as a percentage of total assets, are unusually high in comparison to the comparables it used to derive its discount rate. However, the Division states that any difference in clean-up costs are reflected in cash flows, as the reclamation and remediation costs the Division used in its DCF model to value PETITIONER are at least five times higher than the reclamation and remediation costs estimated for any of the comparables. In addition, the Division believes that it would be improper to value PETITIONER's reclamation and remediation costs at

---

<sup>10</sup> The definition of "allowable costs" in Rule 7(A)(1)(a) include costs for "actual or accrued environmental cleanup, reclamation and remediation[.]" For purposes of the discounted cash flow method, Rule 7(A)(12) defines "net cash flow" to mean "for each future year, the expected product price multiplied by the expected annual production that is anticipated to be sold or self-consumed, plus related revenue cash flows, minus **allowable costs**" (emphasis added). Rule 7 discusses how to develop a discount rate, but makes no mention of separate discount rates for different revenues or costs.

<sup>11</sup> For example, in *Fundamentals of Corporate Finance*, pp. 263-264 (Exhibit 16), the authors, Richard Brealey, Stewart Myers and Alan Marcus, explain that "projects" may have different risks than a "company's existing business," in which case a different discount rate may be appropriate for the project. In addition, in *Cost of Capital, Applications and Examples*, 3<sup>rd</sup> Edition, p. 12, the authors, Shannon Pratt and Roger Grabowski, also explain that a separate project should be valued separately.

risk-free rate of %%%%, while valuing income taxes at the higher rate applied to revenues and other expenses. In addition, upon questioning from the County, PETITIONER REP. 4 indicated that PETITIONER would hope that the estimated future closure costs would decrease due to future technological advances, even though costs could also increase due to new regulatory changes. For these reasons, the Division and County contend that one discount rate should be used to value PETITIONER's property with a DCF model.

The articles that PETITIONER proffered relate to separate, specific projects or investments within a firm or operation. Although PETITIONER characterized its reclamation and remediation costs as a project, it does not appear to be a project in which a firm makes an investment in the classic sense. Rather, it is a clean-up expense imposed by the government. On the other hand, the Division and County argue that a unitary property's value cannot be derived by applying multiple discount rates to its various cash flows, but do not identify or cite any source for this theory. It is possible, if not probable, that a unitary property can have multiple projects, each with its own associated risk, within the unitary operation.

The issue in this case is whether to apply a separate, risk-free rate to a single line item of cash flows attributable to a single source – reclamation and remediation costs. PETITIONER REP. 4 and PETITIONER REP. 5, two of PETITIONER's witnesses, are highly qualified experts in corporate valuation. Their arguments are persuasive, and it is plausible under financial theory that an expense or cost might need to be discounted at a different rate than the rest of the cash flows. Nonetheless, significant concerns remain.

The first of two major issues is the effect that discounting a specific cash flow at a risk-free rate would have on the overall discount rate applied to all other cash flows. It is clear, as PETITIONER REP. 5 admitted, that if a single cash flow is isolated due to its specific characteristics, the single, market-based

discount rate derived from properties that share the same characteristics would have to be adjusted to account for isolating the single cash flow item. More specifically in this case, the discount rate used for the operating cash flows was derived from properties that had reclamation and remediation liabilities, even though of a lower magnitude than the subject property. By discounting this specific cash flow at a risk-free rate, an upward adjustment to the overall discount rate would possibly be required, since a good deal of uncertainty surrounding the reclamation and remediation costs would be removed from cash flow for more typical income and expense estimates.

The other major issue deals with part of PETITIONER's justification for separating the remediation and reclamation costs from the other cash flows. PETITIONER REP. 3 testified that IAS direct that closure costs be recognized as a liability and discounted with a risk-free rate to determine the amount that is "booked" for financial reporting purposes. A discount rate mandated through accounting standards for purposes of financial reporting is not necessarily the same as a market-base discount rate that would be used to estimate fair market value. Associated with this is the fact that a risk-free rate implies a certainty that these costs will be incurred as booked, whereas there is at least a possibility that technological changes and/or other events might mitigate the reclamation and remediation costs.

The Commission also has additional concerns before it departs from the long-standing practice of using a single discount rate in such cases. First, in spite of the financial expertise of PETITIONER REP. 4 and PETITIONER REP. 5, they are not appraisers. Three appraisers testified for the Division and the County, and all of them stated that it would be inappropriate to use separate discount rates for appraisal purposes. PETITIONER did not have an appraiser testify who would refute the position of the Division's and County's appraisers and support the methodology proposed by PETITIONER.

Second, the International Association of Assessing Officers ("IAAO") has issued a Standard on the Valuation of Properties Affected by Environmental Contamination (July 2001) (Exhibit 28), which

provides that “[w]hen regulations require the same improvement to be made by all in an industry, the effect is uniform and costs become part of the typical expenses of the business.” This statement appears to support the Division and County’s position that a single discount rate should be applied to all cash flows. This Standard is consistent with the Commission’s primary concern that segregating cash flow streams requires a separate analysis for each separate cash flow. In this case, the Taxpayer failed to examine the impact on the original discount rate of removing the remediation costs from the Division’s DCF model.

Lastly, PETITIONER argues that its total costs for reclamation and remediation should be deducted from the value derived for its property, citing the Utah Supreme Court’s decision in *Schmidt v. Utah State Tax Commission*, 980 P.2d 690 (Utah 1999). In *Schmidt*, however, the Court considered a single-family residence whose land was contaminated. The Court sustained the Commission’s approach to consider the value of the land separately from the value of the improvements and to reduce the land value to \$\$\$\$\$. In this case, the Commission considered a reduction due to the contamination to be appropriate because the vast majority of single-family residences are not contaminated. These circumstances in *Schmidt* are different from the ones in this appeal because PETITIONER’s contamination issues are not atypical for similar mining properties.<sup>12</sup>

Based on the evidence proffered at the Initial Hearing, the Commission does not have enough evidence to find that a separate, risk-free rate should be applied to PETITIONER’s reclamation and remediation costs when determining a DCF value for PETITIONER’s assets. The Commission sustains the Division’s use of a single rate to discount all cash flows. The Commission does believe, however,

---

<sup>12</sup> Most, if not all, mining properties have contamination issues, whereas most single-family residences do not. PETITIONER also cited *Commerce Holding Corp. v. Bd. of Assessors*, 673 N.E.2d 127 (NY 1996). However, the circumstances in *Commerce Holding* are similar to those in *Schmidt* and, thus, are also dissimilar to the ones in this appeal.

that applying different discount rates to separate cash flows may be appropriate when sufficient analysis is done.

## **II. Use of the Risk Premium Model in Developing a Single Discount Rate.**

For its DCF model, the Division developed a single rate of %%% to discount all of PETITIONER's revenues and expenses. The %%% rate is the sum of an %%% WACC that the Division developed and a %%% weighted average property tax rate. To derive the WACC of %%%, the Division used a debt rate of %%% (weighted at %%%) and an equity rate of %%% (weighted at %%%). The Division derived the equity rate of %%% by using: 1) a Dividend Growth Rate Model rate of %%% weighted at %%%; 2) a Capital Asset Pricing Model rate of %%% weighted at %%%; and 3) a Risk Premium Model ("RPM") rate of %%% weighted at %%%. Exhibit 21. PETITIONER contends that the RPM rate of %%% should not be used in the development of the Division's equity rate and its overall discount rate.

PETITIONER believes that the RPM should not be used for the following reasons. First, the %%% RPM rate is significantly lower than the other two equity rates of %%% and %%% that the Division used to derive its cost of equity. Second, PETITIONER argues that the other two equity rates are ones that are recognized by authorities, while the RPM is not. The Division admits that the RPM rate is not an equity rate found in textbooks, as it was developed by EMPLOYEE, a former Division employee. Third, PETITIONER believes that the %%% RPM rate should not be used because it is an "outlier" when compared to the other two equity rates of %%% and %%%. Fourth, PETITIONER argues that the %%% RPM rate should not be used because it is unreasonably close to the Division's debt rate of %%% and that an equity investor, due to risk, would require a rate of

return substantially higher than the cost of debt. Fifth, PETITIONER argues that even though the RPM rate is questionable because of the foregoing concerns, the Division gave it a %%%%% weight when deriving its cost of equity. Sixth, PETITIONER points out that the Division weighted the RPM rate at %%%%% when developing an overall equity rate for mining properties and natural gas utilities while giving the RPM rate relatively minor weight, or no weight at all, when developing an overall equity rate for all other centrally assessed properties (Exhibit 22).

For these reasons, PETITIONER contends that the RPM rate should be eliminated from the Division's calculation of the cost of equity and WACC. Eliminating the RPM rate would result in a revised WACC of %%%%% (based on a revised equity rate of %%%%% weighted at %%%%% and a debt rate of %%%%% weighted at %%%%%). When the weighted average property tax rate of %%%%% is added to the revised WACC of %%%%, it would result in a discount rate of %%%% to be used in the Division's DCF model instead of the Division's current discount rate of %%%%.

The Division points out that Rule 7(B)(4)(b) provides that when deriving the WACC, the RPM rate is one of the rates that can be used to determine the cost of equity. The Division also points out that the Commission has heard other appeals where it accepted the Division's discount rate, even though a RPM rate had been used in its calculation. In this case, however, the Commission believes that the RPM rate of %%%%% is too dissimilar from the other equity rates and too close to the debt rate to be plausible. The Division admitted that the RPM was developed by EMPLOYEE, a former Division employee, and is not a model recognized by authorities. In addition, the Division admitted that it had departed from the methodology that EMPLOYEE had used in developing the RPM rate, without any explanation why the departure was appropriate. For these reasons, the Commission is not convinced that the RPM rate should be used to develop the overall discount rate. Accordingly, the Division's DCF model should be revised to reflect a discount rate of %%%% instead of %%%%.



The Commission prefers the revised % discount rate described above over PETITIONER's proposed discount rate of %. PETITIONER developed a % discount rate with which it proposed to discount all cash flows except for reclamation and remediation expenses. PETITIONER derived the % discount rate by using an % "base" discount rate (which it claims is a historical average rate used by the Tax Commission) and adjusting the base rate upward by % to account for "property-specific risks," which it identifies as ( WORDS REMOVED ). PETITIONER argues that although it is difficult to quantify these property-specific risks, it has attempted to do so. For example, PETITIONER adjusts the base discount rate of % upward by % to account for its property being located ( WORDS REMOVED ).

The Division argues that these property-specific risks cannot reasonably be quantified. In addition, COUNTY REP. 2, an appraiser who testified on behalf of the County, argues that any property specific risks should be accounted for in cash flows, not in the discount rate, and that the forecasted cash flows have already incorporated these risks. For these reasons, the Commission is not convinced that PETITIONER's proposed discount rate of % is more appropriate than the revised discount rate of % described above. Furthermore, PETITIONER also developed a WACC of % using Ibbotson market risk rates (Exhibit 2, p. 8 of 12). The Division contends that the comparables PETITIONER used to develop this rate are not comparable to mining properties in Utah. Without more information from PETITIONER to refute the Division's assertions, its % proposed WACC is also less unconvincing than the Division's revised % discount rate.

In summary, the Commission finds that a discount rate of % should be used to determine a DCF value for PETITIONER. When the Division's DCF model is revised to reflect a discount rate of % instead of %, it produces an income approach value of approximately \$\$. When

this value is adjusted downward by approximately \$\$\$\$ to account for value taxed elsewhere and non-unit land and improvements (Exhibit 10, pp. 13 and 14), the final income approach value is \$\$\$\$.

### **III. Cost Approach.**

The Commission's revised income approach value is \$\$\$\$\$, which is lower than the Division's cost approach value of \$\$\$\$\$, but higher than PETITIONER's cost approach value of \$\$\$\$\$. The Division's cost approach, however, does not include any adjustment for remediation and reclamation costs, costs that will be incurred and affect value and that both parties recognize and account for in their respective income approaches. For these reasons, the Commission believes that the Division's cost approach should be adjusted downward to reflect the negative effect that reclamation and remediation costs will have on the subject property's value.

The Division's estimated reclamation and remediation costs are lower than PETITIONER's estimated costs, especially for post-closure costs in year 2020. If the Division's estimated reclamation and remediation costs (as shown in Exhibit 11) are discounted at the %%% rate the Commission derived earlier, the present value of the Division's estimated future costs would be approximately \$\$\$\$\$. If PETITIONER's estimated reclamation and remediation costs (as shown in Exhibit 2) are discounted at %%%, the present value of PETITIONER's estimated costs would be even greater. As a result, the Commission believes that the Division's cost approach should be adjusted downward at least \$\$\$\$\$. Adjusting the Division's cost approach value of \$\$\$\$\$ downward by \$\$\$\$\$ would result in a revised cost approach value of \$\$\$\$\$.

Rule 7(B)(1) provides that the DCF method is the preferred methodology to value productive mining property. The revised DCF value that the Commission derived is \$\$\$\$\$. Because this value has not been shown to be “less than the fair market value of the land, improvements, and tangible personal property upon or appurtenant to the mining property,” PETITIONER’s value should be set at \$\$\$\$\$ in accordance with Section 59-2-201(3) and Rule 7(B)(1).

---

Kerry R. Chapman  
Administrative Law Judge

**DECISION AND ORDER**

Based on the foregoing, the Commission finds that the value of PETITIONER’s property should be reduced to \$\$\$\$\$ for the 2009 tax year. It is so ordered.

This decision does not limit a party's right to a Formal Hearing or the right of an affected county to show cause pursuant to Section 59-2-1007 why the Commission should not adjust the values in accordance with this order. However, this Decision and Order will become the Final Decision and Order of the Commission unless an affected party files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission  
Appeals Division  
210 North 1950 West  
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further administrative appeal rights in this matter. In that event, the Property Tax Division is ordered to adjust its records in accordance with this order.

Appeal No. 09-2068

The Property Tax Division is also ordered to calculate the final adjustments to the values apportioned to tax districts as a result of this order and to deliver that information to the affected counties on behalf of the Commission. The auditors of the affected counties are ordered to use the information so provided to adjust their tax roles in accordance with this order.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2011.

R. Bruce Johnson  
Commission Chair

Marc B. Johnson  
Commissioner

D'Arcy Dixon Pignanelli  
Commissioner

Michael J. Cragun  
Commissioner

KRC/09-2068.int